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Fed draws industry concern about liquidity plan for foreign banks' US branches

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IN BRIEF
The US Federal Reserve's request for public input on the question of whether to extend liquidity rules to foreign banks' US branches is drawing the dismay of industry. "The Fed already has ample supervisory tools to ensure the safety and soundness of US branch operations," said Briget Polichene, head of the Institute of International Bankers.

The US Federal Reserve's request for public input on the question of whether to extend liquidity rules to foreign banks' US branches is drawing the dismay of industry.

"The Fed already has ample supervisory tools to ensure the safety and soundness of US branch operations," Briget Polichene, head of the Institute of International Bankers, said in an e-mail today. "We are concerned that imposing a novel liquidity requirement could have the consequence of promoting fragmentation and financial instability."

The Fed sought feedback Monday on treatment of these US branches, which are not subject to standard liquidity requirements like overseas banks' separately capitalized US subsidiaries.

US branches are legally part of their overseas parents, which are overseen by home regulators, and tend to rely heavily on less stable short-term wholesale funding, also known as shadow banking.

"That dynamic has created severe liquidity strain in the US banking system in times of stress, even after the financial crisis," said Fed Governor Randal Quarles, the vice chairman of supervision (see here). "Some degree of certainty about available local resources would form a basis for trust among regulators that might mitigate the human tendency to freeze all available resources in a stress."

The Fed's plan said these branches are often used by overseas banks to fund their global operations.

During the 2007 to 2009 financial crisis, when wholesale lending markets were disrupted, foreign banks' US branches had trouble getting funds, the Fed said.

"This interaction resulted in foreign banking organizations borrowing extensively from the Federal Reserve System in order to continue operations," it said.

In addition, US banks, unlike overseas banks' US branches, are subject to standardized liquidity requirements, resulting in an unlevel playing field, the Fed said.

Polichene, of the global bankers group, urged the Fed to recognize regulation by the home countries of foreign banks that's comparable to that under the US regime.

Foreign jurisdictions apply a host of capital and liquidity standards to their international banks, she said.

— Larger package —

The branch plan is part of a larger package of proposals dealing with Dodd-Frank Act requirements for foreign banks' US operations.

The main part of this package was a rule proposal to ease Dodd-Frank Act capital and stress-test requirements for 17 of the 23 overseas banks, including HSBC, Royal Bank of Canada and UBS. Some of the largest banks would have to hold more liquid assets (see here).

This draft rule contains concrete requirements, unlike the Fed's more preliminary solicitation of comment about US branch liquidity rules.

In dissenting from issuing the entire proposal, Democratic Governor Lael Brainard criticized the decision not to include the US branches plan in the draft rule.

"The US branches of foreign banks can face important run risk during periods of stress," she said Monday. "I am disappointed the proposal today does not address this important outstanding vulnerability."

US branches rely about twice as much on short-term wholesale funding, which is subject to run risks during a crisis, as are overseas banks' US subsidiaries, Brainard said.

Fed data shows that 40 percent of all US assets of foreign banks with at least $50 billion in assets were held in US branches as of June 2018, according to Reuters.

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